Office of the Inspector General
United States Department of Justice

Statement of Glenn A. Fine
Inspector General, U.S. Department of Justice

before the

House Committee on Government Reform
Subcommittee on Government Management, Finance, and Accountability

concerning

The Department of Justice's Fiscal Year 2004 Financial Statement Audit

May 4, 2005

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Mr. Chairman, Congressman Towns, and Members of the Subcommittee on Government Management, Finance, and Accountability:

I. Introduction

I appreciate the opportunity to testify before the Subcommittee about the Department of Justice's (DOJ or Department) Fiscal Year (FY) 2004 Consolidated Financial Statement Audit and the state of the DOJ's financial management systems. FY 2004 was a difficult year for the Department. It received a disclaimer of opinion on its consolidated financial statements and also had its FY 2003 unqualified ("clean") opinion withdrawn and reissued as a disclaimer of opinion. Prior to withdrawal of the FY 2003 opinion, the Department had earned three years of unqualified opinions on its consolidated financial statements.

The reason for the disclaimers was that the Office of Justice Programs (OJP) received a disclaimer of opinion on its FY 2004 and FY 2003 financial statements, and these disclaimers were significant enough to affect the Department's overall consolidated opinions. A second Department component, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF), received a qualified opinion for FY 2004, although that had no effect on the Department's overall consolidated opinion.

On a positive note, the other eight Department components, including the Federal Bureau of Investigation (FBI), the Federal Bureau of Prisons (BOP), the United States Marshals Service (USMS), and the Drug Enforcement Administration (DEA), all continued to earn unqualified opinions for FY 2004. However, the Department's consolidated report included two material weaknesses and one reportable condition, up from one material weakness and one reportable condition in FY 2003. The number of material weaknesses and reportable conditions at the component level increased to 23 from the 19 reported in FY 2003.

It is important to note that the Department faced significant challenges in FY 2004 because of the accelerated reporting timetables imposed on all Executive Branch agencies by the Office of Management and Budget (OMB). The Department's Performance and Accountability Report now must be submitted to the OMB by November 15 of each year. To accomplish this, component audits must be completed within 20 days of fiscal year-end. This means that internal controls must be in place and operating effectively throughout the year. With only 20 days to complete the component audits, effective internal controls are the only way to ensure a successful consolidated result. There simply is no time at year-end to do extensive clean-up of financial records and account balances.

The Office of the Inspector General (OIG) believes the Department's financial controls remain a top management challenge, as we have reported for several years in our "Top Management Challenges" document submitted annually to OMB as part of the Performance and Accountability Report. In our opinion, for long-term success in its financial reporting, the Department must concentrate on standardizing financial processes and systems to more efficiently support accounting operations, facilitate preparation of financial statements, and enable the auditors to streamline their audit processes.

In that regard, the Department has begun the process to obtain a Unified Financial Management System that will replace the seven major accounting systems currently used throughout the Department. Currently, none of the Department's accounting systems are integrated with each other. Consequently, production of Department-wide information must be done manually or by duplicative inputting of data from one system into another. As I discuss later in this statement, the OIG supports this Department initiative and believes it would be a wise investment.

My testimony today will address in more detail three main issues. I will begin with a discussion of how the Department ended up with a disclaimer of opinion on its FY 2004 financial statements, and why the auditors revised the Department's previously unqualified opinion in FY 2003 and downgraded it to a disclaimer. Second, I will discuss the progress made by the Department, and the challenges it faces, on its FY 2005 financial statement opinion. Finally, I will offer the OIG's observations on the long-term challenges faced by the Department and the steps we believe are necessary to improve its financial systems, financial reporting, and ultimately its financial management.

II. FY 2004 and 2003 Opinions

The Department of Justice OIG directs the work of the independent public accounting firms that perform the financial statement audits of the Department's ten reporting components. The consolidated audit is a "rollup" of the ten component results, with the consolidated audit firm relying upon the work of the component auditors.[1] For FY 2004, KPMG LLP was the consolidated auditors and also audited six of the ten components. PricewaterhouseCoopers LLP audited three Department components, while Cotton & Company LLP audited one component. For FY 2003, PricewaterhouseCoopers LLP was the consolidated auditors and also audited five components, while KPMG LLP audited four components, and Urbach Kahn & Werlin LLP audited two components (including the Immigration and Naturalization Service, now part of the Department of Homeland Security).

For FY 2004, OMB accelerated the timeframe for completion of federal financial statement audits – 45 days after close of the fiscal year, as opposed to the 120 days permitted in FY 2003.[2] Under this framework, it is critical that the auditors be able to test internal controls and determine they can rely upon their effectiveness at year-end. Agencies no longer have time at year-end to do extensive manual clean-up or updating of financial data. Similarly, no time is available to validate financial data if audit testing reveals problems during the latter stages of an audit. The auditors must be able to rely on both the agency's financial and information technology (IT) controls, because the financial statements are produced using the agency's IT systems.

As the Department's primary grant-making agency, OJP is particularly dependent on IT controls because all stages of its grant activity are processed electronically from application to cash disbursement to reporting of results. Therefore, if the auditors cannot rely on an agency's internal controls, there is little possibility the audit can be completed within the accelerated OMB reporting deadlines.

Unfortunately, in the OJP FY 2004 audit, the auditors determined that they were unable to rely upon OJP's financial and IT controls. The auditors cited the lack of effective internal controls over computerized information systems used to process grant transactions, inconsistencies in the assumptions made by OJP in determining estimates of its grant accounts payable and grant advance balances, lack of sufficient documentation to support OJP's reconciliation of the grant and non-grant subsidiary ledgers to the general ledger, and OJP's inability to respond to inquiries on advances and transfers-in/out without reimbursement and related budgetary accounts. In other words, OJP was unable to provide sufficient support to validate the

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[1] The ten component audits are: Assets Forfeiture Fund/Seized Asset Deposit Fund; Bureau of Alcohol, Tobacco, Firearms and Explosives; Drug Enforcement Administration; Federal Bureau of Investigation; Federal Bureau of Prisons; Federal Prison Industries, Inc.; Offices, Boards and Divisions; Office of Justice Programs; U.S. Marshals Service; and Working Capital Fund.

[2] After the passage of the Chief Financial Officers Act in 1990, the initial timeframe for completion of federal financial statement audits was 272 days. The timeframe was accelerated to 150 days in FY 1998 and then to 120 days in FY 2002.

balances reported in its financial statements that would enable the auditors to conclude they were fairly presented, in all material respects, in accordance with generally accepted accounting principles.

The auditors also reported five material weaknesses in OJP: 1) improvements needed in cross-cutting elements of OJP's internal control structure, including its control environment, risk assessment, control activities, information and communications, and monitoring of control activities and financial transactions; 2) lack of adequate financial management system controls, including weak controls over changes made to OJP's computerized information systems, weak controls over access to computerized information systems, and system interfaces between mixed feeder systems and the core financial management system need improvement; 3) grant accounting and monitoring, including information related to assumptions made by OJP in estimating grant payables and advances, grant monitoring procedures, and accuracy of grantee financial reports; 4) documenting and maintaining support for adjusting entries; and 5) improvements needed in OJP's financial reporting process to ensure compliance with generally accepted accounting principles.

OJP is one of the Department's largest components in terms of annual appropriations. As a result, its disclaimer of opinion had a material affect on the Department's consolidated balances and caused the Department to receive a disclaimer of opinion.

In another component's audit, the ATF received a qualified opinion on its FY 2004 financial statements because the auditors were unable to rely on ATF's internal controls over its accounts payable accrual methodology. However, because the ATF's accounts payable balances are not material to the Department's consolidated accounts payable balances, this had no affect on the overall consolidated opinion.

In terms of the overall FY 2004 opinion, in addition to the disclaimer of opinion, the consolidated auditors reported two material weaknesses at the consolidated level versus one the previous year. The new issue involved OJP's grant and monitoring policies and procedures. At the component level, the auditors reported a total of ten material weaknesses, which represented an overall increase of one from FY 2003. This was due primarily to the five new OJP material weaknesses previously identified, plus new material weaknesses reported at the ATF and the USMS.

The FBI also had one new material weakness, but because it was able to eliminate one prior year material weakness, it still had a total of two for both FY 2004 and 2003. The good news for the Department was that three components (Assets Forfeiture Fund/Seized Asset Fund; Offices, Boards and Divisions; and Working Capital Fund) were able to eliminate their prior year material weaknesses, and three other components (DEA, BOP, and Federal Prison Industries) continued to have no material weaknesses reported.

Because of the significance of the issues identified at OJP during its FY 2004 audit, the independent public accounting firm that conducted the FY 2003 OJP audit subsequently withdrew its unqualified opinion. OJP's previous auditors determined that additional procedures were needed to resolve these issues, but noted they could not perform such procedures because of the lack of time before the November 15, 2004, due date for all federal agencies' opinions. This action had a cascading affect and resulted in withdrawal of the FY 2003 unqualified opinion on the Department's consolidated financial statements.

To its credit, the Department decided that it wanted to ensure that its financial statements for FY 2003 and FY 2004 were accurate. It therefore decided to bring the auditors back in to look at OJP's FY 2003 and 2004 records and ATF's FY 2004 records, and to resolve the issues found during the FY 2004 audits. The OIG has worked closely with the Department's Chief Financial Officer (CFO) as he seeks to accomplish this task. Work on OJP's FY 2003 financial statements was restarted in January 2005. In recent months, efforts at OJP have concentrated on the grant accrual and general ledger to subsidiary ledger reconciliation efforts – the primary issues of concern. The auditors are nearing completion of the additional FY 2003 work and are beginning their additional work on OJP's FY 2004 financial statements. While the work on OJP's FY 2003 financial statements is not yet complete, the Department has aggressively addressed the issues that the auditors identified, and we believe that they are close to producing a set of FY 2003 financial statements that are materially correct.

The re-audit of the FY 2003 balances has been a significant undertaking because OJP has many and varied grant programs that are included in any accrual estimates. Therefore, multiple variables must be considered in developing the appropriate methodology for the estimates. If these efforts are successful, this should also provide the foundation for success for the FY 2004 and 2005 opinions.

With regard to the ATF, the auditors have been performing testing on the FY 2004 qualified balance and believe that the ATF will be able to come to a materially correct balance. This testing has taken longer than originally anticipated but is expected to be completed soon. We believe that the detailed work performed on the ATF accounts payable balance will ultimately allow for a more accurate and supportable accounts payable balance for FY 2005. Additionally, the auditors will be able to take advantage of the additional work performed on the FY 2004 accounts payable balance to more efficiently test the FY 2005 accounts payable balance.

III. Progress and Challenges in FY 2005

The Department has made progress in its financial management, but it faces various challenges and long-standing issues in order to obtain clean opinions on its financial statements. Some of those issues include the need to use manual workarounds, staffing issues, financial system issues, and data quality issues. Each year's audit has required extraordinary efforts on the part of both the DOJ Finance staff and the auditors as they have struggled to meet accelerating audit due dates, an especially difficult task given the manual workarounds necessary to compile the financial statements.

For the FY 2005 financial statement audit, the Department's CFO and OIG staff have worked together to develop a detailed timeline for completion. This timeline is published as part of the Department's Financial Statements Requirements and Preparation Guide and reemphasized in a joint CFO/OIG memo to all component heads. The OIG is closely monitoring the progress of the individual audits and reporting any problems or slippages in the schedule to the Department's CFO. Also, throughout the audits, senior management of the Department is stressing and reinforcing the requirement to meet the deadlines as part of their periodic meetings on corrective action plans and at other executive-level meetings.

Unlike in previous years, there is only one change in audit firms this year. In FY 2004, there were changes in audit firms at four components and at the consolidated level. The first year of an audit with a new firm is always challenging, as the firm obtains an understanding of the component. In subsequent years, the audit firms are better able to plan and execute audit procedures with the knowledge that was gained in the prior years.

The OIG is also committed to performing IT testing earlier this year to better support the financial auditors' work on the financial statements. The results of the IT testing are used to establish the amount of reliance the financial auditors can place on financial systems and thus help them determine how much testing to perform. Last year we encountered significant delays in obtaining supporting documentation at some components and therefore the auditors were unable to complete the work on schedule. The Department has become even more involved this year in helping ensure that the components address past findings and that the IT audit work is completed timely. When this work is done earlier, auditors can also identify problems and give the Department more time to resolve issues that might prevent the auditors from being able to rely on information system controls at the components, a major issue at OJP last year.

The OIG also has scheduled bi-monthly meetings with the Department's CFO, Deputy CFO, and Chief Information Officer (CIO), along with representatives from all the audit firms, to discuss the progress of the audits and raise any problems that have been encountered.

The Department has many other challenges to overcome in obtaining clean opinions. These include data quality and the ability to timely provide adequate support for transactions during testing. In the past, the auditors encountered problems at some components with the amount of time taken to gather supporting documentation and the completeness of the supporting documentation provided. The Department's financial accounting is decentralized, with many offices processing financial transactions throughout the country and overseas. Therefore, extensive coordination efforts are required on the part of each component to obtain timely audit documentation. Over time, we have seen an overall improvement in data quality and timeliness in providing supporting documentation, although there is still room for improvement. The improvement has been accomplished through increased training for both program and financial staff, establishment of and improved adherence to financial policies and procedures, and better use of dedicated audit liaison staff to facilitate the audits.

Some components also have started instituting aggressive procedures for monitoring controls over their financial data by conducting more frequent internal quality control reviews of financial data and performing monthly closings. Some of the Department's components also have established internal inspection or program review functions that are involved to varying extents in reviewing financial records and processes, which should eventually result in improved quality of financial records and adherence to established controls. We strongly encourage the use of these internal review functions.

The Department and its components must also quickly address audit weaknesses identified from prior years. If not addressed, these weaknesses would be considered even more of a risk by the auditors because of the components' continued failure to resolve them.

On a positive note, we have seen increased involvement by the Department's Justice Management Division in monitoring and assisting with corrective actions at components, and we strongly support this continued involvement. We alert the Department's CFO and CIO staff of any problems we find during the audit, and we regularly brief them to ensure they are aware of where components are struggling with the audit requirements. They have been taking aggressive action in response to our concerns. For example, we support their efforts in holding periodic meetings with the components to discuss the corrective action plans, providing staff or contractor staff to assist components with difficult issues, assisting with training of component finance and program staff, improving financial and IT policies, and using best practices developed by other Department or federal government agencies. The Department is also holding biennial financial management conferences to improve communication and knowledge of financial management practices throughout the Department. In fact, the next Department-wide financial management conference is scheduled for next week.

It also is important to note that the focus of federal financial statement audits has evolved from an audit of ending account balances to an audit of established internal controls, with testing of account balances and activity throughout the year to verify the effectiveness of these internal controls. The auditors must be able to rely upon the effectiveness of the controls in order to be able to opine on the financial statements so close to year-end. Successful testing of the financial statements at interim periods, particularly at June 30 but also at March 31, is critical because it allows the auditors to perform less testing at September 30. But for control testing to be successful at interim, the interim statements must include full accrual accounting. If control testing at interim is not successful, there will not be time to perform detailed substantive testing of account balances at year-end and the probable result will be a disclaimer.

We continue to have concerns about staffing problems at some components, including whether there is sufficient, qualified staff to maintain current, accurate accounting records. This can also be a problem with contractor staff used to supplement the Department's own staff. Where contractors are used, component staff must provide adequate oversight of their work to ensure the work is performed properly. Also, we have sometimes experienced lack of component staff cooperation, which is often evidenced by failure to quickly address prior years' audit issues or failure to timely provide supporting documentation as mentioned above. Yet, we have seen improvements in these staffing areas as the Department's CFO and CIO have stepped in to address these issues aggressively. We will continue to work with them to give the Department every opportunity to timely address its audit issues.

With regard to the problems in OJP and the ATF, the Department's CFO and his staff are working very closely with both components to bring about necessary changes. These efforts include:

- a complete overhaul of financial policies and internal controls at OJP;
- establishment of a Program Review Office in OJP that reports directly to the Assistant Attorney General;
- placement of an Audit Manager at OJP to oversee audit efforts;
- additional contractor resources to support the extra effort required to complete the FY 2003 and 2004 audit work; and
- testing of work done at OJP and the ATF by Justice Management Division staff prior to submission to the auditors, to help ensure success.

These efforts should help improve OJP and ATF's performance on the financial statements this year and in the future.

IV. Long-Term Challenges

Approximately three years ago, the Department initiated efforts to acquire a core Unified Financial Management System to replace the seven legacy financial management systems that are currently in use at Department components. This planned core system would allow standardization and integration of financial processes and systems to more efficiently support financial management operations of the Department. This system would also provide Department managers with more timely, accurate financial information and allow audit processes to be performed more efficiently, including preparation of financial statements.

The Department selected a commercial, "off the shelf" system approximately one year ago. Since then, testing and preparation for implementation of the system have been ongoing. Progress has been slow, however, due primarily to funding constraints. Implementation of the system at the components will be a major challenge for the Department, and thus is planned to be accomplished in a phased approach at the components rather than all at one time. The challenge will be to implement the new system while maintaining current processes, many of which are still manual and require extensive resources.

While this implementation process occurs, the Department and its components also must continue to identify and take corrective actions for the problems identified in the FY 2004 audits, some of which cannot wait for implementation of the new system.

V. Conclusion

The key to success in meeting OMB's accelerated timelines for issuance of the financial statement audit is the quality of accounting records throughout the year. Therefore, effective controls must be enforced at the Department component level to ensure accurate, timely financial information is available throughout the year, not solely after the fiscal year ends. The Department must also continue to develop the quality of its financial staff and ensure it does not become overly dependent on contractors to perform essential financial management functions.

With less than 5 months remaining in FY 2005, it is fair to say that the Department has made substantial strides in addressing significant issues identified during the FY 2004 audits that resulted in a disclaimer of opinion. That said, many difficult issues result from systemic inadequacies in Department systems and controls. It is too early to predict the outcome of the

Department's FY 2005 financial statement audit, but the Department is taking an aggressive approach to resolving its outstanding challenges.

However, it will take a sustained effort on the part of the Department's CFO and CIO, their staff, and the components' staff to improve from a disclaimer to an unqualified opinion. Most importantly, the Department also needs to improve on a long-term basis its ability to provide timely, accurate, and useful financial data throughout the year. The Unified Financial Management System is critical for this challenge, and we believe that adequate resources should be provided to implement it effectively and efficiently.

This concludes my prepared statement. I would be pleased to answer any questions.